Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Section 11 of the	)	
Cable Television Consumer Protection and	)	CS Docket No. 98-82
Competition Act of 1992	)	
	)	
Implementation of Cable Act Reform	)	
Provisions of the Telecommunications Act of	)	CS Docket No. 96-85
1996	)	
	)	
The Commission's Cable Horizontal and Vertical	)	
Ownership Limits and Attribution Rules	)	MM Docket No. 92-264
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COMMENTS AND PETITION FOR RULEMAKING OF
THE NATIONAL CABLE & TELECOMMUNICATIONS ASSOCIATION

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COMMENTS AND PETITION FOR RULEMAKING OF THE NATIONAL CABLE & TELECOMMUNICATIONS ASSOCIATION

The National Cable & Telecommunications Association ("NCTA") hereby submits its Comments on the Further Notice of Proposed Rulemaking in the above-captioned proceeding.

NCTA is the principal trade association representing the cable television industry in the United States. Its members include cable operators serving more than 90% of the nation's cable television subscribers, as well as more than 200 cable programming networks and services. NCTA's members also include suppliers of equipment and services to the cable industry.

INTRODUCTION AND SUMMARY

In the Cable Television Consumer Protection and Competition Act of 1992 (the "Act"), Congress directed the Commission to adopt rules and regulations concerning horizontal and vertical ownership in the cable industry. Now, almost a decade later, the Commission is still wrestling with that mandate and trying to implement it in a way that is consistent with legislative intent and the First Amendment.

The United States Court of Appeals for the District of Columbia Circuit has held that the Act's purposes embody legitimate government interests – namely, "the promotion of diversity in ideas and speech" and "the preservation of competition."[1] But it has also made clear that the Commission's rules cannot pass First Amendment muster unless there is a reasonable evidentiary basis for concluding that they will promote those interests in a way that will not unnecessarily limit the speech rights of cable operators. The rules previously adopted by the Commission did not pass this test, and so the Commission is rightly compiling a new record to determine what limits are appropriate – <u>under today's factual circumstances</u> – to achieve the purposes of the Act.

Current circumstances differ sharply from the state of the marketplace that Congress confronted in 1992. At that time, Congress noted that competition among providers of multichannel video programming services had "not emerged on a

[1] *Time Warner Entertainment Co. v. FCC*, 240 F.3d 1126, 1130 (D.C. Cir. 2001) ("*Time Warner II*"), *quoting Time Warner Entertainment Co. v. United States*, 211 F.3d 1313, 1319 (D.C. Cir. 2000) ("*Time Warner I*").

widespread basis."[2] In particular, while Congress believed that Direct Broadcast Satellites (DBS) "potentially could provide competition to the cable industry,"[3] DBS had not yet even been launched. Today, not only has competition emerged but, as the Commission's annual reports have documented, consumers nationwide now have a choice among providers of multichannel video programming services – including two firmly established and vigorously competitive DBS services.

A second important changed circumstance is that while Congress was, in 1992, concerned with the "explosive growth in vertical relationships between cable operators and program suppliers,"[4] that trend has been dramatically reversed in the past decade. Many of the established program networks that were vertically integrated in 1992 are no longer owned by companies that also own cable operators. And, while the number of channels of programming provided by cable systems has greatly increased, the percentage of those channels occupied by vertically integrated program networks has greatly diminished.

As shown in the attached analysis by Howard Shelanski, formerly Chief Economist at the Commission and currently Acting Professor of Law at the University of California, Berkeley School of Law,[5] both of these changed circumstances are relevant in assessing the appropriateness of ownership restrictions in this proceeding. The emergence of DBS companies as fully competitive alternatives substantially raises the costs to a cable operator of rejecting programming for any reason other than its

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2 Report of the Committee on Energy and Commerce of the House of Representatives, H.R. Rep. No. 92-628, 102d Cong., 2d Sess. 45 (1992) ("House Report").

3 *Id.* at 46.

4 *Id.* at 41.

5 Statement of Howard A. Shelanksi, Jan. 4, 2002 ("Shelanski").

attractiveness to customers. Even if an MSO might want to favor affiliated programming by denying carriage of an unaffiliated competitor, or even if it might want to deny access to viewpoints with which it disagreed, the fact that its customers could nevertheless obtain such programming by switching to one of the DBS providers or some other available competitor would significantly inhibit it from doing so.

Moreover, a sharp decrease in the amount of vertical integration coupled with a large increase in the channel capacity of cable systems means that even if MSOs faced no local competition from DBS and others, there would still be little reason to fear that MSO carriage decisions would be motivated by an incentive to favor affiliated programming rather than a desire to provide the most attractive options to their customers.

There is even less reason – indeed, <u>no</u> reason – to suspect that two or more MSOs might <u>collusively</u> refuse to carry a particular program network. It is quite possible, of course, that multiple MSOs might individually decide not to carry a program network, and that, as a result, the network is unable to reach enough subscribers to ensure its viability. But, as the Court of Appeals pointed out, Congress was not worried about this prospect.

Congress directed the FCC to ensure that no single MSO might act, unilaterally and unfairly, to suppress the flow of programming to viewers and that no group of MSOs might jointly engage in such unfair conduct. There is no way to prevent multiple MSOs from <u>independently</u> choosing not to carry a program network. Nor is there anything unfair, anticompetitive or undesirable about such a result where the purpose and effect is not to suppress the competitive development of programming. This is how a competitive marketplace is supposed to select winners and losers. And there is no reason to set ownership limits based on the theory that multiple MSOs will engage in joint action because there is no evidence or reason to believe that such collusion will occur.

Where there is little reason to expect anticompetitive foreclosure of programming development, there is a serious risk that limits on ownership may do more harm than good. There are efficiencies associated with size that effectively increase the amount and quality of programming available to consumers. If, even with a large share of MVPD subscribers, a single cable operator's programming selection is unlikely to suppress the flow of programming, ownership limits may simply prevent the benefits of those efficiencies.

This is obviously a result that the Commission should seek to avoid in implementing its statutory mandate. Both the First Amendment and the public interest require that any limitation on ownership be no more stringent than necessary to promote diversity and prevent foreseeable anticompetitive suppression of programming.

In any event, if there is to be an ownership cap based on the number of subscribers affected by the programming decisions of a single cable operator, such a cap cannot reasonably be adopted without also revisiting the rules for attributing ownership. The attribution rules for such a cap should be crafted to ensure that only subscribers who are actually affected by the cable operator's programming decisions are counted towards the cap. The current rules effectively establish an irrebuttable presumption that a minority shareholder with a five percent interest in a cable operator will control or influence the programming acquisition and carriage decisions of the cable operator, and, therefore, all the subscribers of the cable operator are attributed to that minority shareholder.

But especially in light of the decline in vertical integration in the cable industry, it is unlikely that a minority shareholder will have any reason to influence programming decisions. It makes more sense at least to establish a rebuttable presumption, in such circumstances, that there is no control or influence and that the subscribers should not be attributed to the minority shareholder.

It is not necessarily the case that the same attribution standard that is appropriate for the cable ownership restrictions will also be appropriate for all other media ownership rules. But it is crucially important, in each case, that the attribution rules only attribute ownership to minority stakeholders who may have the ability and the incentive to influence a company in a way that is relevant to the underlying ownership restriction. And just as the longstanding five percent standard is an inappropriate measure of relevant ownership for purposes of the cable restrictions in light of current marketplace conditions, it may no longer be appropriate for purposes of broadcast and other media ownership restrictions.

Therefore, the Commission should initiate a separate rulemaking proceeding to review and revise as necessary the attribution rules for cable and other media ownership restrictions, and NCTA respectfully petitions the Commission to do so.

I. CHANGED CIRCUMSTANCES HAVE SUBSTANTIALLY DIMINISHED THE ABILITY AND INCENTIVE OF CABLE OPERATORS, REGARDLESS OF THEIR SIZE, TO SUPPRESS THE FLOW OR DIVERSITY OF PROGRAMMING AVAILABLE TO TELEVISION VIEWERS.

When Congress enacted Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992, it was concerned that horizontal consolidation of the cable industry, coupled with increasing vertical integration, could result in the unfair and anticompetitive suppression of diversity and availability of programming for consumers.[6] As the United States Court of Appeals for the District of Columbia Circuit emphasized, Congress was mainly interested in preventing "anticompetitive" behavior.[7] The statutory language "addresses only 'unfair[]' impediments to the flow of programming,"[8] and "it is clear from the structure of the statute that Congress's primary concern in authorizing ownership limits is 'fair' competition."[9]

In holding that Section 11(c) did not, on its face, violate the First Amendment, the Court found that the statute addressed a reasonable concern, based on evidence available at that time.[10] But Congress did not, in Section 11(c), establish specific limits on cable ownership. Instead, it directed the Commission to set appropriate limits that "balance the concerns expressed about concentration with the efficiencies gained by greater integration."[11] And, as the Court of Appeals made clear in *Time Warner II*, the Commission is required to strike that balance based on *current* marketplace conditions and to demonstrate that the limits are necessary to achieve the objectives of the Act: "[I]n 'demonstrat[ing] that the recited harms are real, not merely conjectural,' . . . the FCC must show a record that validates the *regulations*, not just the abstract statutory authority."[12]

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6 *See*, *e.g.*, Report of the Senate Committee on Commerce, Science, and Transportation, S. Rep. No. 102-92, 102d Cong., 1st Sess. 32-33 (1991) ("Senate Report").

7 *Time Warner II*, 240 F.3d at 1136.

8 *Id.* at 1135.

9 *Id.* at 1136.

10 *See Time Warner I*, *supra*, 211 F.3d at 1319-20.

11 Senate Report at 34

12 *Time Warner II*, 240 F.3d at 1130, *quoting Turner Broadcasting System, Inc. v. FCC*, 512 U.S. 622, 664 (1994).

The marketplace circumstances that worried Congress in 1992 have changed significantly. Vertical integration between cable operators and program networks is not only no longer on the rise; it has substantially declined. Meanwhile, as the result of system upgrades and technological advances, the number of channels provided by cable systems has greatly increased. Finally, DBS – which had not even been launched in 1992 – now offers two competitive alternatives nationwide, in addition to cable's other terrestrial competitors. These changes diminish both the ability and the incentive of cable operators to make program carriage decisions in a manner that harms competition or diversity – which, in turn, reduces the likelihood that, at any particular level of concentration, there will be anticompetitive harm that outweighs the potential efficiencies and benefits associated with size.

A. Vertical Integration Has Sharply Declined, While Channel Capacity and the Number of Available Program Networks Has Greatly Increased .

One of the principal reasons why Congress was concerned about <u>horizontal</u> consolidation of cable systems was that many of the larger cable MSOs were <u>vertically</u> integrated. It perceived that "a few large, <u>vertically integrated</u> firms increasingly control large segments of the domestic cable marketplace."[13] It worried that these firms would act in an anticompetitive manner to "favor programming services in which they have an interest, denying system access to programmers affiliated with rival MSOs and discriminating against rival programming services with regard to price, channel

[13] House Report at 41 (emphasis added).

positioning, and promotion"[14] – and that this would, in turn, "reduce diversity in programming by threatening the viability of rival cable programming services."[15]

Even if it were reasonable to assume that vertically integrated firms would unfairly discriminate against unaffiliated programmers, the threat that such discrimination would pose to the flow and diversity of programming today would no longer be worrisome. This is mainly because the trend towards vertical integration has been reversed. A far smaller percentage of the program networks carried by cable systems are vertically integrated today, and, as Professor Shelanski points out, "[t]his change directly reduces the extent to which cable operators could diminish the amount and diversity of programming being offered on the market by discriminating in favor of programming that they own."[16]

In 1992, almost half (48%) of all the national cable programming services were owned by cable operators. Today, only 26% are vertically integrated:

Year	**Number of Vertically Integrated Services**	***Percent of Vertically Integrated Services***	**Number of Non-Vertically Integrated Services**	***Percent of Non-Vertically Integrated Services***	**Total Number of Satellite Delivered Programming Services**
1992	42	***48%***	45	***52%***	87
1994	56	*53%*	50	*47%*	106
1995	66	*51%*	63	*49%*	129
1996	67	*46%*	80	*54%*	147
1997	68	*40%*	104	*60%*	172
1998	95	*39%*	150	*61%*	245
1999	104	*37%*	179	*63%*	283
2000	99	*35%*	182	*65%*	281
2001	73	***26%***	208	***74%***	281

Source: 1999-2000 FCC Annual Competition Reports; NCTA Research

[14] *Id.*

[15] *Id.*

[16] Shelanski at 9.

Moreover, in 1992, "twelve of the top fifteen most-watched services, according to prime-time rankings, [were] vertically integrated, an increase from ten in 1990."[17] And cable had interests in fifteen of the top 25 networks in 1994.[18] But by 2000, according to the Commission's Seventh Annual Competition Report, only 9 of the top 20 networks (in terms of subscribership) – and 5 of the top 10 networks – were vertically integrated in 2000.[19] Only 6 of the top fifteen most watched services, according to prime-time ratings, are vertically integrated today.[20] At the same time, a substantial and increasing number of the non-vertically integrated networks are now owned by large media companies.

Meanwhile, as the percentage of non-vertically integrated programming services has sharply increased, so have the number of channels offered by cable systems and the overall number of programming services available.[21] In 1992, the total number of cable programming services was only 87, of which 45 were not vertically integrated with cable operators. By 2001, the total number of cable programming services had more than tripled – to 281. And, since the percentage of non-vertically-integrated programmers has increased from 52% to 74%, this means that the number of such programmers has more than quadrupled – from 45 to 208.

Thus, it obviously has turned out not to be the case that cable programmers must be vertically integrated or must agree to give cable operators an equity stake in order to compete for carriage on cable systems. And even if cable operators that have an

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[17] *First Report*, 9 FCC Rcd 7442, 7522 (1994).

[18] *Id*. at 7522-23.

[19] *Seventh Annual Report*, 16 FCC Rcd 6005 (2001), at Table D-6.

[20] *Id*. at Table D-7.

ownership interest in program networks were to favor those networks in making carriage decisions, this would not have the stifling effect on competition and diversity in the programming marketplace that Congress feared. The average cable subscriber's system now provides approximately 90 channels of video programming, and the number continues to grow as more and more systems upgrade to 750 MHz of capacity. In this environment, even if every vertically integrated cable operator were to carry every one of its affiliated program networks, there would be more than enough channels to ensure vibrant competition among vertically integrated and non-integrated program networks from multiple, diverse sources.

B. Competition in the Retail Sale of Video Programming Has Effectively Eliminated Incentives To Discriminate Against or Suppress the Quality of Unaffiliated Networks.

As the Commission points out, "Perhaps the most important difference between the industry in 1992 and today is that in 1992 there was no clear nationwide substitute for cable."[22] Even in 1992, when most cable systems were the sole providers of subscription multichannel video programming service in their local communities, cable operators had strong incentives to maximize the value and attractiveness of their channel lineups. Cable was hardly an essential service; only 60 percent of the nation's television households were cable subscribers. Even most cable subscribers spent most of their viewing time watching broadcast television programming. For the remaining 40 percent, the free over-the-air availability of such programming and the availability at video stores

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[21] *See* Notice, ¶ 16.

[22] *Id.*, ¶ 22.

of the same movies available on cable's premium movie channels, along with a multiplicity of other sources of entertainment, provided a sufficient alternative to cable.

Thus, as Professor Shelanski points out, "[c]able providers have long had reason to increase the appeal of their offerings in order to grow their subscriber base, increase revenues by increasing the value of their service to subscribers, and pull viewers away from conventional television and video rentals."[23] Cable operators may have had incentives to invest in, develop and own attractive programming, both to drive cable penetration *and* to derive additional revenues from the sale of such programming to other distributors and, in some cases, the sale of advertising. But any decision to <u>favor</u> affiliated program networks over unaffiliated networks without regard to their relative attractiveness to consumers would have had costs as well as benefits. Even in 1992, the benefits of promoting an affiliated network would have been offset by the opportunity costs of failing to maximize the value of cable service to subscribers.

Today, the costs of discriminating against an attractive but unaffiliated program service have sharply increased while the benefits have diminished. Cable operators are no longer the sole providers of multichannel video programming service in their communities. To the contrary, largely but not only because of the ubiquitous nationwide availability of two DBS providers, virtually all cable subscribers now have choices among comparable multichannel services at comparable prices.

The rapid, steady and continuing growth of DBS has transformed the competitive landscape since 1992. When the horizontal ownership provisions were enacted, DBS was still a <u>prospective</u> competitor. Cable's principal multichannel competitors were C-band

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[23] Shelanski at 5.

satellite services (which served about a million C-band dish customers in rural areas), multichannel multipoint distribution services (with about 300,000 customers), and wireline overbuilders (serving 1.3 million customers).[24] Even by 1994, it was still the case, according to the Commission's first annual report on the Status of Competition in Markets for the Delivery of Video Programming, that "for most consumers, cable television is the only provider of multichannel video programming,"[25] although home satellite dish customers increased to about two million subscribers.[26]

But with the advent of DBS and the growth of other MVPD providers, the number of customers receiving service from someone other than the incumbent local cable operator has increased nearly ten-fold since enactment of the 1992 Act – from 2,330,000 in December 1992 to more than 20,876,000 in September 2001. Cable's share of MVPD subscribers nationwide has dipped below 80%.[27] The growth of competition appears to be steady and irreversible.

Cable's MVPD competition is not limited to DBS. With the deployment of broadband facilities capable of providing video, voice and data services, new overbuilders and utilities – such as RCN/Starpower, Wide Open West, Western Integrated Networks, and Knology – are offering competitive wireline video services as part of "full-service offerings."

But it is DBS that has shown the most remarkable growth spurt. From a standing start in 1992, the two principal DBS providers – DirecTV and EchoStar – now rank third

[24] *Id.*

[25] *First Report*, 9 FCC Rcd at 7540.

[26] *Id.* at 7480 (roughly half of four million HSD users subscribe to one or more programming services).

[27] NCTA, *Cable & Telecommunications Industry Overview* (2001), p. 14.

and sixth among all cable and non-cable MVPDs, serving 10.3 million and 6.4 million customers, respectively.[28] In the last year alone, the total number of DBS subscribers jumped from 14 million in September 2000 to 16.73 million in September 2001 – a 19 percent annual growth rate.

As the Commission's annual Competition Reports have shown, DBS service providers no longer largely target rural or "high-end" customers. Their marketing is aimed directly at cable customers, and the up-front equipment costs that once may have limited their appeal have largely been eliminated. Moreover, to the extent that DBS's inability to provide local broadcast stations ever served as a competitive hindrance, that problem was been removed by the Satellite Home Viewer Improvement Act of 1999. Today, both DBS companies offer consumers everywhere a fully competitive alternative to cable, with comparable programming and comparable prices.

What this means is that a cable operator that refuses to carry attractive programming services may now, in addition to failing to attract new subscribers and failing to maximize revenues from existing subscribers, lose existing customers to its competitors. As the Commission has recognized, "the competitive presence of DBS reduces cable operators' incentive to choose programming for reasons other than quality because a cable operator that selects programming on some other basis risks loss of subscribers if high quality programming is available via DBS."[29] It was obvious, as well,

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[28] *See* "Hughes Reports Third Quarter 2001 Financial Results," Hughes Press Release, Oct. 17, 2001; "EchoStar Reports Over $1 Billion of Revenue, Record EBIDTA and Net Income in Third Quarter," EchoStar Press Release, Oct. 23, 2001.

[29] Notice, ¶ 22.

to the Court of Appeals that "[i]f an MVPD refuses to offer new programming, customers with access to an alternative may switch."[30]

Moreover, competition in the retail sale of multichannel services undermines the incentive and ability of a cable MSO, even if it were to serve the lion's share of MVPD subscribers, to suppress the price it pays for programming in a manner that adversely affects the availability of programming that is attractive to consumers.[31] Such a cable operator would not have the option of capturing monopoly profits by selling less (or lower quality) programming at monopoly prices because consumers in virtually all of the communities that it served could turn to one of the ubiquitously available DBS providers or another competitor that offered more or higher quality programming and/or lower prices.[32]

C. With the Decline of Vertical Integration and the Presence of Competition in the Retail Sale of Multichannel Video Programming Service, the Beneficial Effects of Size Are Likely To Outweigh Any Anticompetitive Harm.

To the extent that the limit on horizontal ownership envisioned by Section 11(c) is meant to prevent a large MSO from inflicting anticompetitive injury on programmers and consumers, the changed circumstances described in the previous sections make it unlikely that any such injury will outweigh any efficiencies and procompetitive benefits associated with size. Congress recognized from the outset that "there are legitimate

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30 *Time Warner II*, *supra*, 240 F.3d at 1134.

31 *See* Shelanski at 5.

32 *See*, *e.g.*, *Addamax Corp. v. Open Software Foundation, Inc*., 888 F. Supp. 274, 280 (D. Mass. 1995), *citing* J. Jacobson & G. Dorman, "Joint Purchasing, Monopsony and Antitrust," *Antitrust Bulletin*, 1, 17 (Spring, 1991); Areeda, et al., *Antitrust Law*, ¶ 574.

reasons for integration,"[33] and that the efficiencies of size may actually serve to promote rather than suppress programming investment and development:

> The Committee . . . is aware that consolidation in the cable industry has brought some benefits to consumers. The Committee believes that the growth of MSOs in the cable industry has produced some efficiencies in administration, distribution, and procurement of programming. Further, programmers' transaction costs also may have been reduced in the absence of the need for negotiation with each of thousands of local cable systems throughout the country. Moreover, large MSOs, able to take risks that a small operator would not, can provide a sufficient number of subscribers to encourage new programming entry.[34]

Thus, Congress specifically directed the Commission to take these procompetitive benefits, "among other public interest objectives,"[35] into account in adopting "reasonable limits"[36] on horizontal ownership. Specifically, the Commission must adopt rules that "account for any efficiencies and other benefits that might be gained through increased ownership and control" and it may "not impose limitations which would impair the development of diverse and high quality video programming."

As the channel capacity of cable systems and the number of cable program services vying for viewers has greatly increased over the last nine years, so, too, have the risks of investing in new programming. In these circumstances, the potential efficiencies and procompetitive benefits that Congress recognized in 1992 are only likely to have become more prominent.

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33 Senate Report at 33.

34 House Report at 43.

35 47 U.S.C. § 533(f)(2).

36 *Id.*, § 533(f)(1).

Moreover, as Professor Shelanski points out, there are potential efficiencies and procompetitive benefits of horizontal integration that go beyond the effects on programming:

> This is particularly the case when enormous investment is being made to upgrade cable networks to higher capacity, two-way systems that can both deliver more channels and allow consumers to send and receive data at high speeds. To the extent that there are scale and scope economies in engineering, equipment procurement, and deployment of technical personnel, there may be good reasons for cable systems to expand their size.[37]

Since the anticompetitive risks identified by Congress have been largely alleviated by the decline in vertical integration and the emergence of DBS providers as fully effective competitors, it is unlikely that the effect of consolidation on competition will, on balance, be anything but positive. And "[t]hat balance itself weighs strongly against any prescriptive ownership prohibition and in favor of the most permissive rule the Commission can promulgate consistent with Congress's mandate."[38]

II. THERE IS NO EVIDENCE – AND NO RATIONAL BASIS FOR EXPECTING – THAT CABLE OPERATORS WILL COLLUDE TO DENY PROGRAMMERS ACCESS TO THEIR SYSTEMS.

As the Court of Appeals made clear, the principal purpose of the horizontal ownership provisions of the statute is to prevent large cable companies from engaging in anticompetitive conduct that artificially suppresses the flow of programming to consumers. And, as shown above, the decline of vertical integration in the cable industry and the development of vibrant competition between cable operators, DBS providers and other MVPDs have made it unlikely that horizontal integration will have such

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[37] Shelanski at 13.

anticompetitive effects. To the contrary, in light of the risks associated with starting a new network, the prospect that a single MSO can deliver and guarantee a large number of subscribers may encourage the development of more programming than would occur in a highly fragmented marketplace.

The Court also suggested, however, that, wholly apart from any anticompetitive actions that a large cable operator might take to purposely exclude a programmer owned by a competitor or to artificially suppress the price – and thus the quality or output – of programming, Congress meant to ensure "that a programmer have at least two conduits through which it can reach the number of viewers needed for viability."[39]

The Court thus held that the Commission could reasonably adopt a limit designed to ensure that no single cable operator had so many subscribers that a programmer could not be viable unless it obtained access to them – although it did not address "the validity of the premises supporting the FCC's conclusion that a 40% 'open field' is necessary."[40] What the Court said that the Commission could not do, however, was adopt a limit designed to prevent two or more operators from collectively having so many subscribers that a programmer could not be viable unless it obtained access to them – at least, in the absence of any evidence or reason to believe that such operators were likely to collude in refusing to carry a particular programmer. The rules are only meant to prevent "unfair" impediments to the flow of programming, and the Court could not "see how the word

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[38] *Id.* at 12.

[39] *Time Warner II* at 1131.

[40] *Id.*

unfair could plausibly apply to the legitimate, <u>independent</u> editorial choices of multiple MSOs."[41]

The Court acknowledged that a <u>joint</u> decision by two or more MSOs to carry or not carry particular services could constitute the sort of unfair conduct that Congress meant to prevent. But when the Commission attempted to justify a horizontal limit designed to ensure that no two MSOs had the power to collusively prevent a programmer from reaching a critical mass of subscribers, the Court found that "the FCC ha[d] put forth no evidence at all that indicates the prospects of collusion," and it vacated the rule.[42]

The Commission is considering, in this proceeding, whether again to adopt a limit designed to ensure that no MSO acting independently – and no MVPDs acting jointly – can foreclose a program network's viability by refusing to carry it. If the Commission pursues this "open field" approach, it will find that it is still the case that there is no evidence supporting the prospect of collusion. Not only is there no evidence that any such collusion among MSOs in the selection of programming has occurred. There is also no reason to believe that MSOs have any incentive to engage in such joint activity.

As Professor Shelanski points out in his paper, cable operators' incentives to collude to deny carriage to a program network or to artificially suppress the price and quality of programming are constrained by the same factors that make <u>unilateral</u> anticompetitive conduct unlikely. The costs of refusing to carry a program network that would be attractive to customers or suppressing the quantity and quality of such networks are likely to outweigh any benefits associated with favoring affiliated program networks or reducing the amount paid for programming:

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[41] *Id.* at 1135 (emphasis added).

> For cable operators to collude in the procurement of programming to the point that program production was harmed would be self-defeating and against the interests of the colluding parties. The colluding cable operators would have to predict that their benefits from reduced payments to the programmer would be greater than their losses from subscribers dissatisfied with receiving the degraded offerings of weakened program producers. . . . That tradeoff becomes increasingly unlikely as subscriber growth rates diminish and especially as competition from other MVPD subscribers like DBS operators increases. <u>Only if the colluding parties have captive customers with relatively inelastic demand for cable services is the tradeoff between program cost and program quality likely to be a generally profitable one. Those conditions do not hold in today's MVPD market</u>.[43]

III. THERE IS NO NEED TO LIMIT CARRIAGE OF VERTICALLY INTEGRATED PROGRAM NETWORKS IN ORDER TO PREVENT THE PROBLEMS THAT CONGRESS SOUGHT TO ADDRESS.

The concerns that caused Congress to direct the Commission to establish "reasonable limits on the number of channels that can be occupied by a video programmer in which a cable operator has an attributable interest" were similar to the concerns underlying the horizontal ownership provisions of the 1992 Act. And just as changes in the marketplace have, for the reasons described above, largely alleviated the horizontal ownership concerns, those same changes have eliminated any need for vertical limits.

Congress was specifically concerned that "vertical integration gives cable <u>operators</u> the incentive and ability to favor their affiliated <u>programming services</u>."[44] This concern was fueled by "the increased vertical integration in the cable industry," and by

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42 *Id.* at 1133.

43 Shelanski at 10-11 (emphasis added).

44 Senate Report at 25.

the "lack of local competition" faced by cable operators[45] – neither of which is still the case.

Vertical integration is no longer increasing. As shown above, it has dramatically declined since 1992, while channel capacity has sharply increased. Moreover, the marketplace for the sale of multichannel video programming services is vibrantly competitive.

And as a result, vertical integration is no longer accompanied by the incentive or the ability to discriminate in a manner that inflicts anticompetitive harm on unaffiliated programmers or MVPDs – or on consumers. This is because the decline in vertical integration and increase in channel capacity limits the <u>impact</u> that vertically integrated companies could have on competition and diversity even if such companies were consistently to favor their affiliates. Even when the Commission adopted its former rules, at a time when vertical integration was more prevalent, it "recognized that the need for a vertical limit would likely decrease as channel capacity increased" and operators needed to fill more available channels.[46] The declining percentage of programming services owned by cable operators guarantees that cable operators will need to purchase unaffiliated services to fill their expanded channel capacity.

Meanwhile, the established availability of two national DBS providers and other competitors as alternatives to incumbent cable operators throughout the country raises the costs of discriminating against unaffiliated companies and removes incentives to do so. As the proponents of the 1992 legislation made clear, their concern that vertically integrated cable operators could and would discriminate against unaffiliated programmers

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[45] *Id.* at 24.

was premised on the notion that "cable systems are not subject to effective competition"[47] and that "the guy who controls a monopoly conduit is in a unique position to control the flow of programming traffic to the advantage of the program services in which he has an equity investment . . . and to the disadvantage of those services . . . in which he does not have an equity position."[48]

For reasons discussed above, competition from the DBS companies and others means that a cable operator that makes carriage decisions for reasons other than to provide the most attractive selection of programming will incur a cost in loss of subscribers and revenues to its MVPD competitors. As the Court of Appeals recognized in questioning the Commission's refusal to exempt cable operators subject to effective competition from its vertical limits, "exposure to competition will have an impact on a cable company's ability to indulge in favoritism for in-house productions. After all, while reliance on in-house suppliers offering an inferior price-quality trade-off will reduce a monopolist's profits, it may threaten a competitive firm's very survival."[49] Moreover, the ability to harm an unaffiliated program network is reduced because refusal to carry the network by no means forecloses its access to viewers in the communities served by the cable operator.

What this means is that limiting the number of channels on a cable system that may be occupied by vertically integrated programmers is no longer necessary or useful to advance the government's interest in ensuring that cable operators do not discriminate

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[46] Notice, ¶ 75.

[47] Senate Report at 24.

[48] *Id.* at 26 (*quoting* Testimony of Preston Padden (INTV)).

[49] *Time Warner II*, 240 F.3d at 1138.

against unaffiliated program networks in a way that thwarts competition and diversity. The interest may be a legitimate government interest. But competition among incumbent cable operators, DBS providers and other MVPDs is sufficiently vibrant to prevent such discrimination without any channel occupancy limits. Thus, to the extent that such limits interfere with an operator's editorial discretion in selecting the array of programming that best meets the interests and demands of consumers in this competitive marketplace, they will inherently – and unconstitutionally – "burden more speech than <u>necessary</u>" to further the government's interests.[50]

IV. PETITION FOR RULEMAKING: THE COMMISSION SHOULD INITIATE A RULEMAKING PROCEEDING TO REVIEW AND REVISE THE ATTRIBUTION RULES APPLICABLE TO ALL MEDIA OWNERSHIP RESTRICTIONS.

In trying to determine whether any particular level of ownership of cable systems is likely to lead to the sort of "unfair" and anticompetitive conduct that Congress meant to prevent, the definition of "ownership" is obviously a relevant factor. It makes sense to attribute ownership of a cable system, for this purpose, to a particular entity only if the program carriage decisions for that system can be affected by that entity in ways the rule is intended to address.

The current attribution rule, under which all of the subscribers of a cable operator are attributed to any entity with five percent of the voting power of that operator, is not, on its face, appropriately tailored to the purposes of a horizontal ownership cap or the channel occupancy limits. Unless there is reason to believe that a five percent shareholder participates in and, as discussed below, controls the program selection and

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[50] *Turner Broadcasting System, Inc. v. FCC*, 520 U.S. 180, 189 (1997) (*quoting United States v. O'Brien*, 391 U.S. 367, 377 (1968)) (emphasis added).

procurement activities of the cable operator, it is hard to see any reason why the shareholder should be attributed with ownership of that system for purposes of these rules.

The Commission has in the past maintained that its longstanding five percent rule was reasonable for purposes of its 1992 horizontal ownership rules largely because, "in widely held corporations, an owner of 5% or more would ordinarily be one of the two or three largest shareholders," and, "with such ownership a holder of 5% or more would be able 'to potentially affect the outcome of elective or discretionary decisions and command the attention of management.'"[51]

As an initial matter, the rule applies to all corporations, not just widely held corporations, and there are many instances in which a 5% ownership holder will <u>not</u> be the largest shareholder in a corporation. For example, a corporation could have a 5% owner and four other owners with 25%, 25%, 25%, and 20% ownership shares. In this scenario, it would be unrealistic to believe that the 5% owner could control or "affect the outcome of" the decisions of the corporation, and it certainly would be unreasonable to impose an <u>irrebuttable</u> presumption of such control or influence. So, at the very least, the 5% rule is overbroad.

Use of the 5% threshold for purposes of implementing both the horizontal rules and the channel occupancy limits also automatically (and irrationally) assumes that an entity with an interest in a cable operator and a separate interest in a programming service will have the incentive to attempt to persuade the cable operator to disfavor rivals of the

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[51] *Time Warner II*, *citing Implementation of the Cable Television Consumer Protection and Competition Act of 1992*, 14 FCC Rcd 19014, 19034 (1999), and *quoting Attribution of Ownership Interests*, 97 F.C.C. 2d 997, 1005-06 (1984).

programming service. Again, the overbreadth of the rule is readily apparent. For example, the entity may have $100 million invested in the cable system and only $10 million (through a 5% interest) in a programming network, but the rules irrebuttably presume that the $100 million investment will be subordinated to the $5 million investment. Plainly, it would economically irrational for anyone to do so.

Moreover, it is not clear that a 5% owner of a cable system would have the ability to persuade the system to make decisions that would favor the 5% owner by foreclosing rival programming services. As shown above and by Professor Shelanski, DBS and other competitive alternatives substantially raise the costs to a cable operator of rejecting programming for any reason other than its attractiveness to customers. The fact that a cable operator's customers could obtain such programming by switching to one of the DBS providers or some other available competitor would significantly inhibit the operator from pursuing a foreclosure strategy. This suggests that even at common ownership levels far greater than 5%, the conduct to which the rule is targeted is unlikely to occur.

More importantly, a cable operator would be particularly unlikely to degrade its optimal programming carriage decisions in order to favor the programming affiliates of a 5% owner. This is so because the benefits and costs of foreclosure are not distributed in the same manner. If the cable operator were to foreclose a rival of its 5% owner, it would experience all of the <u>loss</u> (in terms of subscribers that drop cable service in favor of a competitive MVPD as a result of the foreclosure) but <u>none</u> of the gain, because it does not own the favored programmer. It would not make sense for the cable operator to pursue this strategy.

Even if the management of a corporation were inclined to act in such a manner, it would be inconsistent with its fiduciary duty to its other owners. Corporate directors and officers have a fiduciary obligation to act in the best interests of the corporation, including a duty to conclude transactions that are fair and beneficial to the corporation as a whole.[52] In short, corporate managers are constrained by their fiduciary duties from engaging in a foreclosure strategy that advantages the affiliated programming of a 5% owner when, as noted above, such a strategy would clearly <u>not</u> be in the economic interest of the other owners.

Other than to favor its own program networks, how and why is a minority shareholder likely to influence the programming decisions of a cable operator? The answer is hardly obvious. Indeed, what is often obvious is that the minority shareholder exerts no such influence or control. For example, while AT&T has owned a 25% interest in Time Warner Entertainment for years, there is no evidence that AT&T has ever influenced the network carriage decisions of TWE. Similarly, if there were in fact a benefit enjoyed by programming networks affiliated with cable operators, how can one explain the significant moves away from integration, including Viacom's sale of its cable systems and the more recent Liberty Media spin-off? Yet the Commission's current attribution rule creates an <u>irrebuttable</u> presumption that a shareholder with as little as a five percent interest <u>does</u> participate in and affect the outcome program carriage decisions.

In cases where this presumption is wrong, the result will be that a merger will be barred even though the actual number of subscribers affected by a cable operator's

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52 Model Business Corporation Act, §§ 8.30, 8.42, 8.60-8.63 (1999).

programming decisions is fewer than the number deemed by the Commission to be in any way problematic. And this, in turn, means that procompetitive efficiencies associated with size or clustering, which may benefit consumers and programmers will be lost for no reason at all.[53]

This suggests that the interest of a minority shareholder ought not to be counted towards the horizontal cap unless there is some indication that the minority shareholder has exercised or will exercise control over the operator's programming selection and acquisition activities. In other words, there should be, at the very least, a rebuttable presumption that a minority shareholder does not exercise such influence or control and that its subscribers will not be counted for purposes of the horizontal ownership rules.[54]

In any event, this is a matter that the Commission needs to consider in conjunction with the adoption of new cable ownership rules. An ownership limitation based on the number of subscribers reached by a cable operator and an attribution rule that determines whether interests of minority shareholders are to be counted towards such a limitation are two interdependent factors of the same equation, and it makes no sense to address one without considering the other.

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[53] Because the rule precludes any additional investments, the Commission's reliance on SEC reporting requirements is misplaced. The SEC rules simply require disclosure of the investment; in no way do they cap the investment at that level. In contrast, the FCC rules forbid further investment once the rule is triggered.

[54] Under such an approach, there would, of course, be no need for a "single majority shareholder" exemption – since minority shareholders would not be presumed to exercise influence or control regardless of whether or not there is a single majority shareholder. But if the Commission were to continue to attribute ownership to minority shareholders with some specified level of ownership, it would certainly be appropriate to maintain the single majority shareholder exemption. If the reason for attributing ownership to a minority shareholder is that, in a publicly held company, the shareholder may, in fact, be one of the largest individual stakes in the company, the presence of a single majority shareholder obviously undermines that presumption. There is no evidence and no basis in fact or logic for presuming, in these circumstances, that a minority shareholder exercises any influence or control over the programming decisions of a cable operator.

This is true, of course, for all media ownership rules. It is not necessarily the case that the same attribution standard will be appropriate across the board for all media ownership rules. But it is crucially important, in all cases, that the attribution rules attribute ownership to a minority stakeholder in a media company only in those circumstances where it is reasonable to presume that such a stakeholder can and will influence the company in a manner that is relevant to the underlying ownership restriction.

Accordingly, as the Commission comprehensively undertakes not only to revise the cable ownership rules in this proceeding but also to review its other media ownership rules to reflect current marketplace conditions, it should conduct a separate rulemaking proceeding to ensure that the attribution rules are accurately and appropriately tailored to the underlying purposes of each particular ownership restriction. NCTA respectfully petitions the Commission to initiate such a proceeding.

CONCLUSION

The marketplace in which cable operators acquire and provide programming to customers has been transformed by a sharp decline in the amount of vertical integration, a large increase in channel capacity, and – most importantly – the ubiquitous availability of DBS services in addition to other competitors in the retail sale of multichannel video programming services. As a result, cable operators, regardless of their size, have little ability or incentive to suppress the flow or diversity of programming – either independently or collusively – in the manner feared by Congress when it enacted the ownership provisions of the 1992 Act. Limits on ownership that are premised on the expectation of such anticompetitive activity will serve no public interest and will only stifle the potential efficiencies and procompetitive benefits associated with size.

In any event, the Commission cannot reasonably adopt caps on ownership without reviewing and revising the standards for ownership attribution. Therefore, the Commission should initiate a separate rulemaking proceeding to consider appropriate attribution standards for all its media ownership rules.

Respectfully submitted,

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